

ANNUAL STATEMENT FOR THE YEAR 2002 OF THE RECIPROCAL OF AMERICA, IN RECEIVERSHIP

ASSETS

	Current Year			Prior Year
	1 Assets	2 Nonadmitted Assets	3 Net Admitted Assets (Cols. 1 - 2)	4 Net Admitted Assets
1. Bonds .....	188,066,262		188,066,262	262,711,233
2. Stocks:				
2.1 Preferred stocks (Schedule D, Part 2, Section 1) .....	670,763		670,763	
2.2 Common stocks (Schedule D, Part 2, Section 2) .....	34,786,906		34,786,906	55,661,695
3. Mortgage loans on real estate (Schedule B):				
3.1 First liens .....				
3.2 Other than first liens .....				
4. Real estate (Schedule A):				
4.1 Properties occupied by the company (less \$ ..... encumbrances) .....	3,169,054		3,169,054	3,361,976
4.2 Properties held for the production of income (less \$ ..... encumbrances) .....				
4.3 Properties held for sale (less \$ ..... encumbrances) .....				
5. Cash (\$ ..... (8,614,482) Schedule E, Part 1) and short-term investments(\$ .....96,475,675 Schedule DA, Part 2) .....	87,861,193		87,861,193	32,316,963
6. Other invested assets (Schedule BA) .....	10,400,000	10,400,000		5,564,522
7. Receivable for securities .....				
8. Aggregate write-ins for invested assets .....	950,536	950,536		874,870
9. Subtotals, cash and invested assets (Lines 1 to 8) .....	325,904,714	11,350,536	314,554,178	360,491,259
10. Agents' balances or uncollected premiums:				
10.1 Premiums and agents' balances in course of collection .....	14,942,146	285,634	14,656,512	1,762,266
10.2 Premiums, agents' balances and installments booked but deferred and not yet due (Including				
\$ ..... earned but unbilled premiums) .....	13,175,738		13,175,738	16,181,565
10.3 Accrued retrospective premiums .....				
11. Funds held by or deposited with reinsured companies .....				
12. Bills receivable, taken for premiums .....	500,000		500,000	
13. Amounts receivable under high deductible policies .....				
14. Reinsurance recoverables on loss and loss adjustment expense payments (Schedule F, Part 3, Cols. 7 and 8) .....	21,723,836		21,723,836	19,878,761
15. Federal and foreign income tax recoverable and interest thereon (including \$ .....80,766,096 net deferred tax asset) .....	80,828,521	80,766,096	62,425	3,900,308
16. Guaranty funds receivable or on deposit .....	19,950		19,950	7,259
17. Electronic data processing equipment and software.....	660,257		660,257	821,986
18. Interest, dividends and real estate income due and accrued .....	1,893,657		1,893,657	4,337,300
19. Net adjustments in assets and liabilities due to foreign exchange rates .....				
20. Receivable from parent, subsidiaries and affiliates .....				
21. Amount due from/to protected cells .....				
22. Equities and deposits in pools and associations .....				
23. Amounts receivable relating to uninsured accident and health plans .....				
24. Other assets nonadmitted (Exhibit 1) .....				
25. Aggregate write-ins for other than invested assets .....	54,526,915	25,425,716	29,101,199	3,179,714
26. Total assets excluding protected cell assets (Lines 9 through 25) .....	514,175,734	117,827,982	396,347,752	410,560,417
27. Protected cell assets .....				
28. TOTALS (Lines 26 and 27)	514,175,734	117,827,982	396,347,752	410,560,417
DETAILS OF WRITE-INS				
0801. NOTES RECEIVABLE.....	950,536	950,536		874,870
0802. ....				
0803. ....				
0898. Summary of remaining write-ins for Line 8 from overflow page .....				
0899. Totals (Lines 0801 thru 0803 plus 0898) (Line 8 above)	950,536	950,536		874,870
2501. DEDUCTIBLE RECOVERABLE.....	1,858,479		1,858,479	1,650,094
2502. AMOUNTS DUE FROM REINSURANCE COMPANIES - DEPOSITS.....	27,131,510		27,131,510	1,015,769
2503. MISCELLANEOUS RECEIVABLE.....	111,210		111,210	513,851
2598. Summary of remaining write-ins for Line 25 from overflow page .....	25,425,716	25,425,716		
2599. Totals (Lines 2501 thru 2503 plus 2598) (Line 25 above)	54,526,915	25,425,716	29,101,199	3,179,714

LIABILITIES, SURPLUS AND OTHER FUNDS

	1 Current Year	2 Prior Year
1. Losses (Part 2A, Line 34, Column 8) .....	263,411,648	213,461,704
2. Reinsurance payable on paid loss and loss adjustment expenses (Schedule F, Part 1, Column 6) .....	24,564,344	
3. Loss adjustment expenses (Part 2A, Line 34, Column 9) .....	147,846,799	99,097,350
4. Commissions payable, contingent commissions and other similar charges .....		5,661,803
5. Other expenses (excluding taxes, licenses and fees) .....	2,561,743	1,464,165
6. Taxes, licenses and fees (excluding federal and foreign income taxes) .....	1,370,000	1,132,772
7. Federal and foreign income taxes (including \$ ..... on realized capital gains (losses)) (including \$ ..... net deferred tax liability) .....		
8. Borrowed money \$ ..... and interest thereon \$ .....		
9. Unearned premiums (Part 1A, Line 37, Column 5) (after deducting unearned premiums for ceded reinsurance of \$ .....32,900,232 and including warranty reserves of \$ ..... ) .....	21,365,396	31,159,668
10. Advance premiums .....		
11. Dividends declared and unpaid:		
11.1 Stockholders .....		
11.2 Policyholders .....	4,616,789	4,616,789
12. Ceded reinsurance premiums payable (net of ceding commissions) .....	11,048,476	12,231,212
13. Funds held by company under reinsurance treaties (Schedule F, Part 3, Column 19) .....		
14. Amounts withheld or retained by company for account of others .....	481,427	26,358
15. Remittances and items not allocated .....	1,621,386	2,551,579
16. Provision for reinsurance (Schedule F, Part 7) .....	126,713,000	
17. Net adjustments in assets and liabilities due to foreign exchange rates .....		
18. Drafts outstanding .....		
19. Payable to parent, subsidiaries and affiliates .....		
20. Payable for securities .....		
21. Liability for amounts held under uninsured accident and health plans .....		
22. Capital Notes \$ .....and interest thereon \$ .....		
23. Aggregate write-ins for liabilities .....	339,972	1,578,211
24. Total liabilities excluding protected cell liabilities (Lines 1 through 23) .....	605,940,980	372,981,612
25. Protected cell liabilities .....		
26. Total liabilities (Lines 24 and 25) .....	605,940,980	372,981,612
27. Aggregate write-ins for special surplus funds .....		
28. Common capital stock .....		
29. Preferred capital stock .....		
30. Aggregate write-ins for other than special surplus funds .....		
31. Surplus notes .....	19,495,096	22,932,596
32. Gross paid in and contributed surplus .....		
33. Unassigned funds (surplus) .....	(229,088,324)	14,646,209
34. Less treasury stock, at cost:		
34.1 ..... shares common (value included in Line 28 \$ ..... ) .....		
34.2 ..... shares preferred (value included in Line 29 \$ ..... ) .....		
35. Surplus as regards policyholders (Lines 27 to 33, less 34) (Page 4, Line 38) .....	(209,593,228)	37,578,805
36. TOTALS (Page 2, Line 28, Col. 3)	396,347,752	410,560,417
DETAILS OF WRITE-INS		
2301. OTHER LIABILITIES.....	339,972	1,578,211
2302. ....		
2303. ....		
2398. Summary of remaining write-ins for Line 23 from overflow page .....		
2399. Totals (Lines 2301 thru 2303 plus 2398) (Line 23 above)	339,972	1,578,211
2701. ....		
2702. ....		
2703. ....		
2798. Summary of remaining write-ins for Line 27 from overflow page .....		
2799. Totals (Lines 2701 thru 2703 plus 2798) (Line 27 above)		
3001. ....		
3002. ....		
3003. ....		
3098. Summary of remaining write-ins for Line 30 from overflow page .....		
3099. Totals (Lines 3001 thru 3003 plus 3098) (Line 30 above)		

UNDERWRITING AND INVESTMENT EXHIBIT STATEMENT OF INCOME

	1 Current Year	2 Prior Year
<b>UNDERWRITING INCOME</b>		
1. Premiums earned (Part 1, Line 34, Column 4) .....	130,568,672	120,763,292
<b>DEDUCTIONS</b>		
2. Losses incurred (Part 2, Line 34, Column 7) .....	144,789,837	113,761,790
3. Loss expenses incurred (Part 3, Line 25, Column 1) .....	94,496,480	80,022,089
4. Other underwriting expenses incurred (Part 3, Line 25, Column 2) .....	25,198,538	35,821,794
5. Aggregate write-ins for underwriting deductions .....		
6. Total underwriting deductions (Lines 2 through 5) .....	264,484,855	229,605,673
7. Net income of protected cells .....		
8. Net underwriting gain or (loss) (Line 1 minus Line 6 plus Line 7) .....	(133,916,183)	(108,842,381)
<b>INVESTMENT INCOME</b>		
9. Net investment income earned (Exhibit of Net Investment Income, Line 17) .....	12,139,263	15,331,536
10. Net realized capital gains or (losses) (Exhibit of Capital Gains (Losses)) .....	(14,325,191)	5,956,623
11. Net investment gain or (loss) (Lines 9 + 10) .....	(2,185,928)	21,288,159
<b>OTHER INCOME</b>		
12. Net gain or (loss) from agents' or premium balances charged off (amount recovered \$ ..... amount charged off \$ .....417,929 ) .....	(417,929)	(98,317)
13. Finance and service charges not included in premiums .....	25,600	11,925
14. Aggregate write-ins for miscellaneous income .....	(1,058,972)	105,189
15. Total other income (Lines 12 through 14) .....	(1,451,301)	18,798
16. Net income before dividends to policyholders and before federal and foreign income taxes (Lines 8 + 11 + 15) .....	(137,553,412)	(87,535,424)
17. Dividends to policyholders .....		
18. Net income, after dividends to policyholders but before federal and foreign income taxes (Line 16 minus Line 17) .....	(137,553,412)	(87,535,424)
19. Federal and foreign income taxes incurred .....	159,027	21,036
20. Net income (Line 18 minus Line 19) (to Line 22) .....	(137,712,439)	(87,556,461)
<b>CAPITAL AND SURPLUS ACCOUNT</b>		
21. Surplus as regards policyholders, December 31 prior year (Page 4, Line 38, Column 2) .....	37,578,803	128,764,449
<b>GAINS AND (LOSSES) IN SURPLUS</b>		
22. Net income (from Line 20) .....	(137,712,439)	(87,556,461)
23. Net unrealized capital gains or (losses) .....	(2,278,439)	(11,929,739)
24. Change in net unrealized foreign exchange capital gain (loss) .....		
25. Change in net deferred income tax .....	49,585,514	15,450,897
26. Change in nonadmitted assets (Exhibit 1, Line 5, Col. 3) .....	(78,223,779)	(15,050,811)
27. Change in provision for reinsurance (Page 3, Line 16, Column 2 minus Column 1) .....	(126,713,000)	
28. Change in surplus notes .....	(3,437,500)	9,062,500
29. Surplus (contributed to) withdrawn from protected cells .....		
30. Cumulative effect of changes in accounting principles .....		7,941,725
31. Capital changes:		
31.1. Paid in .....		
31.2. Transferred from surplus (Stock Dividend) .....		
31.3. Transferred to surplus .....		
32. Surplus adjustments:		
32.1. Paid in .....		
32.2. Transferred to capital (Stock Dividend) .....		
32.3. Transferred from capital .....		
33. Net remittances from or (to) Home Office .....		
34. Dividends to stockholders (cash) .....		
35. Change in treasury stock (Page 3, Lines 34.1 and 34.2, Column 2 minus Column 1) .....		
36. Aggregate write-ins for gains and losses in surplus .....	51,607,612	(9,103,757)
37. Change in surplus as regards policyholders for the year (Lines 22 through 36) .....	(247,172,031)	(91,185,646)
38. Surplus as regards policyholders, December 31 current year (Line 21 plus Line 37) (Page 3, Line 35) .....	(209,593,228)	37,578,803
<b>DETAILS OF WRITE-INS</b>		
0501. ....		
0502. ....		
0503. ....		
0598. Summary of remaining write-ins for Line 5 from overflow page .....		
0599. Totals (Lines 0501 thru 0503 plus 0598) (Line 5 above) .....		
1401. MISCELLANEOUS INCOME (EXPENSE) .....	(1,058,972)	105,189
1402. ....		
1403. ....		
1498. Summary of remaining write-ins for Line 14 from overflow page .....		
1499. Totals (Lines 1401 thru 1403 plus 1498) (Line 14 above) .....	(1,058,972)	105,189
3601. RETURN OF SUBSCRIBERS' EQUITY.....	(587,995)	(8,272,790)
3602. PRIOR PERIOD ADJUSTMENT.....	(913,773)	
3603. PREFERRED STOCK REDEMPTION.....		(830,967)
3698. Summary of remaining write-ins for Line 36 from overflow page .....	53,109,380	
3699. Totals (Lines 3601 thru 3603 plus 3698) (Line 36 above) .....	51,607,612	(9,103,757)

CASH FLOW

	1 Current Year	2 Prior Year
Cash from Operations		
1. Premiums collected net of reinsurance	109,495,973	122,392,632
2. Loss and loss adjustment expenses paid (net of salvage and subrogation)	118,797,847	140,214,592
3. Underwriting expenses paid	29,016,705	34,639,796
4. Other underwriting income (expenses)		
5. Cash from underwriting (Line 1 minus Line 2 minus Line 3 plus Line 4)	(38,318,579)	(52,461,756)
6. Net investment income	14,569,606	15,415,241
7. Other income (expenses):		
7.1 Agents' balances charged off	(417,929)	(98,317)
7.2 Net funds held under reinsurance treaties		
7.3 Net amount withheld or retained for account of others	455,069	(154,814)
7.4 Aggregate write-ins for miscellaneous items	(2,284,302)	4,246,883
7.5 Total other income (Lines 7.1 to 7.4)	(2,247,162)	3,993,753
8. Dividends to policyholders on direct business , less \$ dividends on reinsurance assumed or ceded (net)	0	8,984,959
9. Federal and foreign income taxes (paid) recovered	3,678,856	366,832
10. Net cash from operations (Line 5 plus Line 6 plus Line 7.5 minus Line 8 plus Line 9)	(22,317,279)	(41,670,889)
Cash from Investments		
11. Proceeds from investments sold, matured or repaid:		
11.1 Bonds	683,455,352	298,438,058
11.2 Stocks	34,339,043	90,068,567
11.3 Mortgage loans		
11.4 Real estate		
11.5 Other invested assets		
11.6 Net gains or (losses) on cash and short-term investments		
11.7 Miscellaneous proceeds	(75,666)	213,000
11.8 Total investment proceeds (Lines 11.1 to 11.7)	717,718,729	388,719,625
12. Cost of investments acquired (long-term only):		
12.1 Bonds	603,145,675	357,544,884
12.2 Stocks	29,100,316	8,800,150
12.3 Mortgage loans		
12.4 Real estate		
12.5 Other invested assets		
12.6 Miscellaneous applications		
12.7 Total investments acquired (Lines 12.1 to 12.6)	632,245,991	366,345,034
13. Net Cash from investments (Line 11.8 minus Line 12.7)	85,472,738	22,374,591
Cash from Financing and Miscellaneous Sources		
14. Cash provided:		
14.1 Surplus notes, capital and surplus paid in	(3,437,500)	9,062,501
14.2 Capital notes \$ less amounts repaid \$		
14.3 Net transfers from affiliates		
14.4 Borrowed funds received		
14.5 Other cash provided	105,930,768	17,327,424
14.6 Total (Lines 14.1 to 14.5)	102,493,268	26,389,925
15. Cash applied:		
15.1 Dividends to stockholders paid		
15.2 Net transfers to affiliates		
15.3 Borrowed funds repaid		
15.4 Other applications	110,104,496	3,310,974
15.5 Total (Lines 15.1 to 15.4)	110,104,496	3,310,974
16. Net cash from financing and miscellaneous sources (Line 14.6 minus Line 15.5)	(7,611,229)	23,078,951
RECONCILIATION OF CASH AND SHORT-TERM INVESTMENTS		
17. Net change in cash and short-term investments (Line 10, plus Line 13, plus Line 16)	55,544,230	3,782,653
18. Cash and short-term investments:		
18.1 Beginning of year	32,316,962	28,534,309
18.2 End of year (Line 17 plus Line 18.1)	87,861,192	32,316,962
DETAILS OF WRITE-INS		
07.401 FINANCE CHARGES	25,600	11,925
07.402 MISCELLANEOUS INCOME (EXPENSE)	(1,058,972)	105,189
07.403 A/P OTHER	(1,250,930)	4,129,769
07.498 Summary of remaining write-ins for Line 7.4 from overflow page		
07.499 Totals (Lines 07.401 thru 07.403 plus 07.498) (Line 7.4 above)	(2,284,302)	4,246,883

## NOTES TO FINANCIAL STATEMENTS

### 1. Summary of Significant Accounting Practices

The accompanying financial statements of Reciprocal of America have been prepared on the basis of accounting practices prescribed or permitted by the State Corporation Commission and the Bureau of Insurance of the Commonwealth of Virginia. The Virginia Bureau of Insurance requires insurance companies domiciled in the Commonwealth of Virginia to prepare their statutory financial statements in accordance with the National Association of Insurance Commissioners' (NAIC) *Accounting Practices and Procedures Manual* subject to any deviations prescribed or permitted by the Virginia Bureau of Insurance.

On January 29, 2003, the Circuit Court of the City of Richmond, Virginia, found that Reciprocal of America (the "Company") and The Reciprocal Group ("TRG" and collectively, the "Companies") are in a condition, as a single insurance business enterprise, where any further transaction of business will be hazardous to the policyholders, creditors, members, subscribers, and the public. Therefore, the Court issued its Final Order Appointing Receiver for Rehabilitation or Liquidation (the "Receivership Order"), appointing the State Corporation Commission (the "Commission") of the Commonwealth of Virginia, as Receiver, Alfred W. Gross, the Commissioner of the Commission's Bureau of Insurance (the "Bureau"), as Deputy Receiver, and Melvin J. Dillon as Special Deputy Receiver of the Companies.

The liabilities of Reciprocal of America will be processed pursuant to the authority granted in the Receivership Order. On January 29, 2003, the Deputy Receiver issued his First Directive Continuing Insurance Policy Payments and Imposing Suspension and Moratorium on Other Claim Payments (the "First Directive"). The First Directive ordered a continuation of all payments to policyholders, subscribers, and third-party claimants whose claims arise under insurance policies issued by Reciprocal of America ("Insurance Policy Claims"). The First Directive also ordered a moratorium upon the payment of all other claims, including all general creditor claims, which are subordinate to Insurance Policy Claims. This financial statement has been prepared in conformity with the format adopted by the Bureau, and, as such, this financial statement does not segregate the liabilities of Reciprocal of America by order of payment priority. In this connection, some of the liabilities listed in this financial statement may never be paid if Reciprocal of America has insufficient assets available to satisfy its administrative expenses and Insurance Policy Claims.

The Receivership Order directed the Receiver, Deputy Receiver, and Special Deputy Receiver to take control and possession of all of the Companies' property and affairs. The Special Deputy Receiver and authorized representative, who have executed the financial statement, take the place of the board of directors for the purpose of the financial statement and answers to the various "General Interrogatories" contained herein. Also, the General Interrogatories are answered to the best of the Special Deputy Receiver and authorized representative's knowledge, and the answers to such questions may be subject to change or further revision.

Information for periods prior to the receivership is presented as previously reported to the Bureau by the Company, or as presented in the books and records of the Company. The Deputy Receiver continues to evaluate the way in which the Company reported its pre-receivership information. Before the Company was placed in receivership, the Companies operated under previously adopted protocols and agreements. The Deputy Receiver and Special Deputy Receiver continue to evaluate these protocols and agreements, and the results of this evaluation may necessitate further changes to the Company's financials.

#### Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in these financial statements and notes. Actual results could differ from these estimates.

#### Accounting Policies

Premiums are earned pro rata over the terms of the related policies and reinsurance contracts. Unearned premiums are established to cover the unexpired portion of premiums written. Such reserves are determined on a monthly pro rata basis for direct business and are based on reports received from ceding companies for reinsurance assumed.

Expenses incurred in connection with acquiring new insurance business are charged to operations as incurred. Expenses incurred are reduced for ceding allowances received or receivable.

Net investment income earned consists primarily of interest, dividends and rent income less investment related expense. Interest is recognized on an accrual basis and dividends are recognized on an ex-dividend basis. Rent income includes an imputed rent for the Company's occupancy of its own building. Net realized capital gains (losses) are recognized on a specific identification basis when securities are sold, redeemed or otherwise disposed. Realized capital losses include writedowns for impairments considered to be other than temporary.

In addition, the Company uses the following accounting policies:

- (1) Short-term investments are stated at amortized cost using the interest method.
- (2) Investment grade bonds not backed by other loans are reported at amortized cost using the interest method. Non-investment grade bonds with NAIC designations of 3 through 6 are stated at the lower of amortized cost or fair value.
- (3) Common stocks are reported at fair value as determined by the Securities Valuation Office of the NAIC.
- (4) Preferred stocks are stated at fair value.
- (5) Mortgage Loans -- N/A
- (6) Mortgage-backed securities are valued at amortized cost using the interest method. The retrospective adjustment method is used to value all loan-backed securities. Non-investment grade loan-backed securities are stated at the lower of amortized value or fair value.
- (7) Investments in Subsidiaries -- N/A
- (8) Investments in Joint Ventures and Partnerships -- N/A
- (9) Investments in Derivatives -- N/A
- (10) The Company does not anticipate investment income as a factor in the premium deficiency calculation in accordance with SSAP No. 53, Property-Casualty Contracts – Premiums.
- (11) Unpaid losses and loss adjustment expenses include an amount determined from individual case estimates and loss reports and an amount, based on past experience, for losses incurred but not reported. Such liabilities are necessarily based on assumptions and estimates and while management believes the amount is adequate, the ultimate liability may be in excess

NOTES TO FINANCIAL STATEMENTS

of, or less than, the amount provided. The methods for making such estimates, and for establishing the resulting liability, are continually reviewed and any adjustments are reflected in the period determined.

2. Accounting Changes and Corrections of Errors
- A. The Company established an accrual for guaranty fund and related assessments in year 2002, based upon review of its past experience and information obtained from various state guaranty funds. A portion of this accrual should have been established in prior periods. As a result, the Company recorded \$913,773 of this accrual as a prior period adjustment directly to surplus.

B. Accounting Changes as a Result of Codification -- Accounting changes adopted to conform to the provisions of the NAIC Accounting Practices and Procedures Manual are reported as changes in accounting principles. Many changes were made to this manual effective January 1, 2001 as a result of the NAIC "Codification Project". The cumulative effect of changes in accounting principles is reported as an adjustment to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported as of the date when the new accounting principle became effective, with the net difference applied retroactively as an adjustment for all prior periods. As a result of these changes, the Company reported a change in accounting principle, as an adjustment to unassigned surplus in the amount of \$7,941,725, for the year ended December 31, 2001.
3. Business Combinations and Goodwill
- On January 31, 2001, the Company assumed the assets and liabilities of Coastal Insurance Enterprises, Inc., Coastal Insurance Exchange, and Alabama Hospital Association Trust. On April 1, 2001, the Company assumed the assets and liabilities of Healthcare Workers' Compensation Trust Fund. The four companies provided professional and general liability coverage to physicians and hospitals and workers' compensation insurance coverage to physicians, hospitals, and other allied facilities primarily in the state of Alabama. All 2001 transactions for the above four entities and Reciprocal of America were reported on a combined basis for the current period as if the assumptions had all taken place January 1, 2001.
4. Discontinued Operations – None
5. Investments
- A. Mortgage Loans – N/A

B. Debt Restructuring – N/A

C. Reverse Mortgages – N/A

D. Loan-Backed Securities

(1) The Company has elected to use book value on January 1, 1994, as the cost for applying the retrospective adjustment method to securities prior to that date.

(2) Prepayment assumptions for loan-backed bonds and structured securities were obtained from broker dealer survey values or internal estimates.

(3) The Company used Financial Times Interactive Data (“IDC”) to determine market value of its loan-backed securities.

(4) The Company had no negative yield situations requiring a change from the retrospective to prospective method.

E. Repurchase Agreements – N/A
6. Joint Ventures, Partnerships and Limited Liability Companies – N/A
7. Investment Income
- A. Accrued Investment Income

The Company does not record investment income due and accrued if amounts are over 90 days past due (180 days for mortgage loans or amounts on mortgage loans in default).

B. Amounts Non-admitted – N/A
8. Derivative Instruments - N/A
9. Income Taxes
- A. Components of the net deferred tax asset (DTA's) and deferred tax liabilities (DTL's) recognized in the Company’s assets, liabilities, surplus and other funds are as follows:

	December 31, 2002	January 1, 2002
(1) Total of gross deferred tax assets	\$ 80,766,096	\$ 31,204,892
(2) Total of deferred tax liabilities	(0)	(24,310)
(3) Net deferred tax assets	80,766,096	31,180,582
(4) Deferred tax assets non-admitted	(80,766,096)	(27,518,442)
(5) Net admitted deferred tax assets	\$ 0	\$ 3,662,140
(6) (Increase) decrease in non-admitted deferred tax assets	\$(53,247,654)	\$(7,148,276)

B. Unrecognized DTL's -- N/A

C. Current Tax and Change in Deferred Tax -- The current provisions for federal and foreign income taxes incurred on earnings for the years ended December 31 were:

	2002	2001
Federal	\$136,154	\$ -
Foreign	22,873	21,036
	159,027	21,036
Federal income tax on net capital gains	-	-
Utilization of capital loss carry-forwards	-	-
Federal and Foreign income taxes incurred	\$ 159,027	\$ 21,036

NOTES TO FINANCIAL STATEMENTS

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	December 31, 2002	January 1, 2002
Deferred tax assets:		
Discounted Loss and LAE reserves	\$17,211,874	\$ 13,953,261
Change in unearned premium reserve	1,499,029	2,118,857
Contingent commission	-	1,925,013
NOL carryforward	48,878,711	8,411,506
AMT carryforward	122,280	359,647
Foreign tax credit carryforward	217,237	40,381
IRC Sec 481 adjustments	-	883,160
Statutory assets not admitted	12,588,818	1,840,588
Unrealized losses	<u>248,147</u>	<u>1,672,479</u>
Total deferred tax assets	80,766,096	31,204,892
Nonadmitted deferred tax assets	<u>(80,766,096)</u>	<u>(27,518,442)</u>
Admitted deferred tax assets	\$ -	\$ 3,686,450
Deferred tax liabilities:		
Dividends accrued	-	(24,310)
Total deferred tax liabilities	-	(24,310)
Net admitted deferred tax assets	\$ -	\$ <u>3,662,140</u>

The change in net deferred income taxes is comprised of the following (this analysis is exclusive of non-admitted assets as the Change in Non-admitted Assets is reported separately from the Change in Net Deferred Income Taxes in the surplus section of the Annual Statement):

	December 31, 2002	January 1, 2002	Change
Total gross deferred tax assets	\$ 80,766,096	\$ 31,204,892	\$ 49,561,204
Total gross deferred tax liabilities	-	(24,310)	24,310
Net deferred tax assets (liability)	\$ <u>80,766,096</u>	\$ <u>31,180,582</u>	49,585,514
Deferred tax on change in unrealized gains (losses)			1,424,332
Tax effect of statutory non-admitted assets			(8,929,981)
Change in net deferred income tax			\$ <u>42,079,865</u>

D. Reconciliation of Federal Income Tax Rate to Actual Effective Rate -- The provision for federal and foreign income taxes incurred is different from that which would be obtained by applying the statutory Federal income tax rate to income before income taxes. The significant items causing this difference are as follows:

	December 31, 2002	Effective Tax Rate
Provision computed at statutory rate	\$ (46,768,160)	(34.00%)
Tax exempt income deduction	(7,536)	(0.01%)
Dividends received deduction	(92,246)	(0.07%)
Meals and entertainment	156,655	0.11%
Lobbying	10,656	0.01%
Subscriber Credit Addback	<u>4,779,793</u>	<u>3.47%</u>
Totals	<u>\$ (41,920,838)</u>	<u>(30.48%)</u>
Federal and foreign income taxes incurred	\$159,027	0.12%
Change in net deferred income taxes	<u>(42,079,865)</u>	<u>(30.59%)</u>
Total statutory income taxes	<u>\$ (41,920,838)</u>	<u>(30.48%)</u>

E. Operating Loss and Tax Credit Carryforwards

(1) The Company has net operating loss carryforwards which expire as follows:

\$7,039,127	generated in 1997 that expires at the end of 2013
\$4,942,280	generated in 1999 that expires at the end of 2019
\$10,163,444	generated in 2000 that expires at the end of 2020
\$6,573,471	generated in 2001 that expires at the end of 2021
\$115,042,595	generated in 2002 that expires at the end of 2022

(2) The following are income taxes incurred in the current and prior years that will be available for recoupment in the event of future net losses: None

F. Consolidated Federal Income Tax Return -- N/A

10. Information Concerning Parent, Subsidiaries and Affiliates

- A. Nature of Relationships - The Company is a Reciprocal Insurer and has no parent.
- B. Detail of Transactions Greater than 1/2% of Admitted Assets – N/A
- C. Change in Terms of Intercompany Arrangements - N/A
- D. Amounts Due to or from Related Parties - See below.
- E. Guarantees or Contingencies for Related Parties - See Footnote 13 for description of the Company's guarantor status on a loan between TRG and Wachovia Bank (formerly First Union Bank).
- F. Management, Service Contracts, Cost Sharing Arrangements

TRG is the attorney-in-fact for the Company and provides certain specified administrative services and supplies. In return, the Company is charged an administrative fee by TRG. These administrative fees were charged by TRG to the Company

## NOTES TO FINANCIAL STATEMENTS

on a cash basis. Administrative fees charged by TRG to the Company were \$22,005,896 and \$24,385,045 for the years ended December 31, 2002 and 2001, respectively.

The Company has loans outstanding from TRG at December 31, 2002 as follows:

- 1) Demand Loan at 10% interest per annum in the amount of \$850,169, which has been non-admitted.
- 2) Demand loan at 8% per annum in the amount of \$35,952, which has been non-admitted.
- 3) Demand loan at 8% per annum in the amount of \$64,415, which has been non-admitted.

- G. Nature of Control Relationships that Could Affect Operations - N/A
- H. Amount Deducted for Investment in Upstream Company - N/A
- I. Detail of Investments in Affiliates Greater than 10% of Admitted Assets - N/A
- J. Write-down for Impairments in Subsidiary, Controlled or Affiliated Companies - N/A

11. Debt – N/A .

12. Retirement Plans, Deferred Compensation, Postemployment Benefits and Compensated Absences and Other Postretirement Benefit Plans – The Company has no direct employees and consequently, no employee benefit plans.

13. Capital and Surplus, Shareholders' Dividend Restrictions and Quasi-Reorganizations

- (1) Outstanding Shares - N/A
- (2) Dividend Rate of Preferred Stock - N/A
- (3-5) Dividend Restrictions - On April 16, 2002, the Company's Board of Directors adopted a policy prohibiting equity distributions to withdrawn or terminated subscribers if the Company's RBC ratio is less than 400%, or if such distributions would cause the Company's surplus to fall below the minimum required policyholder's surplus of \$4,000,000. The Board of Directors also adopted a policy whereby no equity distributions will be made to withdrawn or terminated subscribers until all equity funds raised pursuant to the Company's Capitalization Plan, completed as of June 30, 2002, are returned to those subscribers that contributed capital as part of the Capitalization Plan.

On January 29, 2003, the Deputy Receiver issued his First Directive. The First Directive ordered a moratorium upon the payment of claims, which are subordinate to Insurance Policy Claims. The moratorium will include a suspension on any equity distributions to withdrawn, terminated, or current subscribers.

- (6) Mutual Surplus Advances - N/A
- (7) Company Stock Held for Special Purposes - N/A
- (8) Changes in Special Surplus Funds - N/A
- (9) Changes in Unassigned Funds due to the following significant items:
  - a. Unrealized gains and losses: \$(2,278,439)
  - b. Nonadmitted asset values: \$(78,223,779)
  - c. Provision for reinsurance: \$(126,713,000)
  - d. Deferred tax asset: \$49,585,514
  - e. Capital contribution \$53,109,380

(10) Surplus Notes:

Wachovia Bank Notes:

On March 31, 1992, the Company and TRG entered into a Revolving Credit Loan Agreement ("Loan Agreement") with First Union (formerly Dominion Bank and now known as Wachovia Bank) of Richmond, National Association. The Loan Agreement was subsequently amended on December 31, 1994. Proceeds of \$3.750 million from this Loan Agreement were advanced to the Company as a surplus advance under Section 38.2-1225 of the Virginia Insurance Code by the attorney-in-fact, TRG, to the Company under a separate Revolving Credit Loan Agreement between the Company and TRG dated March 31, 1992. The Loan Agreement converted to a Term Loan on March 31, 1994, pursuant to certain conditions of this agreement unless renewed for successive one-year periods after March 31, 1994. Under the amendment dated December 31, 1994, the term note would be repaid in four (4) equal annual installments beginning on December 31, 1998. Under an amendment dated December 1, 1998, the scheduled payment due on December 31, 1998, was deferred until December 31, 2001. Under an amendment dated December 17, 1999, the scheduled payment due on December 31, 1999, was deferred until December 31, 2001. Under an agreement dated December 13, 2000, the scheduled payment due on December 31, 2000, was deferred until February 1, 2001, and was made on January 31, 2001. Under an agreement dated December 31, 2001, the remaining principal balance was to be paid in three equal installments due April 1, 2002, April 1, 2003 and April 1, 2004. On March 31, 2002, the first of the three installments, due April 1, 2002, was made in the amount of \$937,500. The agreement dated December 31, 2001, provided for quarterly interest payments at an annual rate of one and one-quarter percent above the LIBOR Market Index Rate. The Company is a Guarantor on the loan between TRG and Wachovia Bank. Unpaid accrued interest was \$-0- as of December 31, 2002.

On March 29, 2001, TRG entered into a Revolving Credit Note with Wachovia Bank (formerly known as First Union National Bank). Through a subordinated promissory note, TRG advanced the \$10 million in proceeds to the Company as a surplus advance. Interest is to be paid quarterly at an annual rate which is one and one-quarter percent per annum above the LIBOR Market Index Rate. The principal sum was due on July 31, 2002. The Company is a Guarantor on the Revolving Credit Note between TRG and Wachovia Bank. Unpaid accrued interest was \$-0- as of December 31, 2002.

On May 9, 2002, TRG, ROA and Wachovia Bank (the "Bank") entered into a Modification Agreement in which the Bank agreed to an accelerated repayment schedule in exchange for waivers of the Company's noncompliance with certain covenants on TRG's \$10 million Revolving Credit Agreement and TRG's \$3,750,000 (remaining balance of \$2,812,500 at this time) Term Note. For the Revolving Credit Agreement, the Modification Agreement required TRG or its guarantor, the Company, to make four equal payments of \$2.5 million on June 15, 2002, July 1, 2002, July 15, 2002, and July 31, 2002, instead of the



## NOTES TO FINANCIAL STATEMENTS

original repayment schedule of \$10 million on July 31, 2002. The first of these \$2.5 million payments was made on June 28, 2002, by TRG and collected from the Company, which was approved by the Bureau. Under a Second Modification Agreement with the Bank dated July 31, 2002, the scheduled \$2.5 million payment from July 1, 2002, was deferred to, and made on, July 31, 2002, by The Reciprocal Insurance Agency, Ltd., a subsidiary of TRG, on behalf of the Company. The July 2002 payment was not approved by the Bureau. The scheduled \$2.5 million payments from July 15, 2002, and July 31, 2002, were deferred to a combined \$5 million payment due on August 30, 2002. Under a Third Modification Agreement with the Bank, dated September 1, 2002, the scheduled \$5 million payment due on August 30, 2002, was deferred to December 1, 2002. In addition, TRG provided the Bank with a non-contingent, irrevocable letter of credit for \$5 million issued by another bank. For the Term Note, the scheduled payments due on April 1, 2003, and April 1, 2004, were accelerated to October 1, 2002. Under a Fourth Modification Agreement with the Bank, dated November 1, 2002, the scheduled October 1, 2002, payment for the Term Note, as well as the scheduled payment due December 1, 2002, for the Revolving Credit Agreement, were deferred to October 31, 2003. In addition, TRG amended the non-contingent, irrevocable letter of credit issued by another bank from \$5 million to \$9 million, to cover the remaining \$2,812,500 portion of the Term Note and the remaining \$5,000,000 portion of the Revolving Credit Agreement. Subsequent to December 31, 2002, as discussed in Note 21, Wachovia Bank determined an event of default had occurred, and consequently, the bank drew upon the letter of credit and satisfied all remaining balances due under the Fourth Modification Agreement.

Missouri Hospital Plan Note:

On August 17, 2000, the Company and the Missouri Hospital Plan (MHP) entered into a subordinated loan agreement. The principal amount of \$10,120,095.80 was effectuated by the transfer from MHP to the Company of investment grade securities on December 1, 2000. Under an agreement dated December 13, 2001, the parties agreed that during the time period of January 1, 2001, to December 31, 2002, payment of interest is to be made by allocating the same to the Company subscriber equity accounts of the MHP Book of Business. Repayment of the loan is the earlier of (i) the effective date as defined in the Master Agreement dated August 17, 2000, which both parties executed concerning a business combination, or (ii) six months after the effective date of the termination of the Master Agreement. In April 2002, MHP informed the Company of its intent to unwind from the proposed business combination defined in the Master Agreement dated August 17, 2000. Under a mutual understanding between the parties and subject to the Missouri Department of Insurance and the Bureau approvals, the Company intended to repay the principal amount of the surplus advance to MHP by transferring to MHP the securities held under the subordinated loan agreement. The repayment was not approved by the Bureau. Simultaneously, the Company intended to transfer to MHP (i.e. for the twelve months ended December 31, 2001, and the six months ended June 30, 2002) the operating results of the MHP book of business, either via novation or assumption reinsurance agreement, with such results to be recorded in 2002. This novation or assumption reinsurance agreement did not take place in 2002, and consequently, the Company is in default of the repayment provisions of the subordinated loan agreement.

(11-12) Quasi Reorganizations - N/A

#### 14. Contingencies

- A. Contingent Commitments - N/A
- B. Guaranty Fund and Other Assessments

The Company is subject to guaranty fund and other assessments by the states in which it writes insurance business. These assessments are accrued at the time of assessments or, in the case of premium based assessments, when the premiums are written for insurance policies. In the case of loss based assessments, the assessment is accrued when losses are incurred.

The Company established an accrued liability for guaranty fund and other assessments in 2002, and the balance of such liability was \$1,055,221, with a related premium tax benefit asset of \$19,950. A portion of the assessment accrual should have been recognized in prior years; thus, the Company established a prior period adjustment to surplus as discussed in Note 2 for such assessment. This represents management's best estimate based on information received from the states in which the Company writes insurance business. Management's estimate may change due to many factors, including the Company's share of the ultimate cost of current insolvencies.

- C. Gain Contingencies - N/A
- D. All Other Contingencies

The Company is named as defendant in various legal actions arising principally from claims made under insurance policies and contracts. Those legal actions, which involve claims made under insurance policies and contracts, are considered by the Company in estimating reserves for losses and loss adjustment expenses. The Company's insureds are also parties to litigation in various state jurisdictions, and the ultimate liability of the Company for such litigation matters is subject to a variety of factors and difficult to quantify. The Company has considered these litigation matters in its estimate of losses and loss adjustment expenses.

In various litigation matters, policyholders of the Company, The Reciprocal Alliance ("TRA"), or Doctors Insurance Reciprocal ("DIR") may be named as parties in the same litigation. In these litigation matters, TRA and DIR are neither providing their policyholders with a defense nor paying the insurance claims of their policyholders. The non-payment of policyholder claims by TRA and DIR may cause a disproportionate amount of legal liability to be apportioned to the Company's policyholders in the above-referenced litigation matters. The possibility of the above loss contingency is not known and cannot be reasonably quantified by the Deputy Receiver. The financial statements do not reflect the possible loss from the herein described litigation contingency.

As discussed in Note 21, subsequent to December 31, 2002, the Company was placed into receivership by the Circuit Court of the City of Richmond on January 29, 2003, naming the Commission as the receiver. Subsequent to January 29, 2003, several class action lawsuits have been filed which include the Company among the list of defendants. It cannot be determined at this time the potential impact on the Company's financial condition as a result of these actions.

On January 31, 2003, Commissioner Flowers petitioned the Chancery Court of the State of Tennessee (the "Court"), Twentieth Judicial District, Davidson County, for an order to place TRA, DIR, and American National Lawyers Insurance

NOTES TO FINANCIAL STATEMENTS

Reciprocal ("ANLIR") into receivership. On that same date, the Court placed TRA, DIR, and ANLIR (collectively, "Risk Retention Groups" or "RRG's") into receivership and appointed Commissioner Flowers as rehabilitator (the "Rehabilitator") of the Risk Retention Groups. The Company acted as a reinsurer for the Risk Retention Groups. In March 2003, the Rehabilitator of the Risk Retention Groups filed an appeal with the Deputy Receiver and subsequently, in April 2003, with the Commission, seeking a determination that the Company and Risk Retention Groups are a single business enterprise. Among the various requests for equitable relief, the Rehabilitator seeks an injunction against the continued payment of ROA's insurance policy claims. The Rehabilitator seeks to have the Company use its assets to pay the Risk Retention Group claims on the same priority level as the Company's policyholders. The Rehabilitator's appeal is now under review.

15. Leases

In April 2002, the Company began leasing standard desktop and laptop personal computer equipment under a non-cancelable operating lease that expires in March 2005. Rental expense for 2002 was \$367,303. Future minimum rental payments are as follows:

2003	\$459,098
2004	402,219
2005	<u>55,907</u>
Total	<u>\$917,224</u>

The Company has not entered into any sales and leaseback arrangements.

16. Information About Financial Instruments with Off-Balance Sheet Risk and Financial Instruments with Concentrations of Credit Risk – N/A
17. Sale, Transfer and Servicing of Financial Assets and Extinguishments of Liabilities – N/A
18. Gain or Loss to the Reporting Entity from Uninsured A & H Plans and the Uninsured Portion of Partially Insured Plans -- N/A
19. Direct Premium Written/Produced by Managing General Agents /Third Party Administrators- N/A

20. Other Items

- A. Extraordinary Items - As discussed in Note 21, subsequent to December 31, 2002, the Company was placed into receivership by the Circuit Court of the City of Richmond on January 29, 2003, and the Commission was named as the receiver.
- B. Troubled Debt Restructuring for Debtors - N/A
- C. Uncollectible Receivables -- In addition to various reinsurance recoverables discussed in Note 22, the Company has a receivable due from First Virginia Reinsurance, LTD. ("FVR") totaling \$24,400,000. As a result of FVR's apparent inability to honor its reinsurance obligations to the Company, this receivable has been fully non-admitted.
- D. Reinsurance Accounted for as a Deposit -- Effective April 1, 2002, the Company entered into a new reinsurance agreement with General Reinsurance Corporation ("GenRe"), covering health care facility professional and general liability coverage ("Cover A") as well as workers' compensation and employers' liability coverage ("Cover B"), subject to an aggregate limit. For the term of April 1, 2002 to December 31, 2002, the Company ceded 57.1% of the subject net written premium for Cover A and 45.2% of the subject net written premium for Cover B, along with the respective percentages of the subject unearned premium at April 1, 2002, all subject to a ceding commission of 35%. The agreement is subject to an experience balance calculation that may extend the term of the agreement through December 31, 2003. As of December 31, 2002, the Company has recorded an asset totaling \$26,101,189 which represents the remaining funds on deposit with GenRe to cover future claims obligations subject to this agreement.

The Bureau has advised that the reinsurance agreement does not transfer risk and that remedial measures should be taken by the Company. The Deputy Receiver is evaluating the GenRe reinsurance agreement and remedial action measures.

E. Other Disclosures:

On January 1, 2001, the Company changed its name from The Virginia Insurance Reciprocal to Reciprocal of America.

The Company is the Guarantor on a lease between TRG and Fund III and Fund IV Associates for certain premises in a building located at 4400 Cox Road, Glen Allen, Virginia 23060, and the Company may reject its responsibility as a guarantor.

The Company elected to use rounding in reporting amounts in this statement.

The Company is a Reciprocal Insurer and has allocated, on Page 11 (Part 3), the management fee (\$22,005,896) it paid its Attorney-in-Fact as required by the NAIC. The expenses were allocated to the same general accounts and at the same percentages as they were carried, in the records of the Attorney-in-Fact.

The Company has no employees.

21. Events Subsequent

On January 29, 2003, the Commission was named receiver by the Circuit Court of the City of Richmond for the Company and the Company's attorney-in-fact, TRG. After an examination, the Bureau of Insurance found the Company and TRG to be in a hazardous financial condition. The Company has continued to pay all claims arising under the Company's policies of insurance.

NOTES TO FINANCIAL STATEMENTS

The Company will no longer issue new or renewal insurance policies. Subsequent to the receivership, several class action law suits have been filed which include the Company among the list of defendants. It cannot be determined at this time the potential impact on the Company's financial condition as a result of these actions.

As discussed in Note 13, the Company, along with it's attorney-in-fact TRG, were parties to a Fourth Modification Agreement with Wachovia Bank, the proceeds of which were provided to the Company as a surplus advance. In February 2003, Wachovia Bank determined an event of default had occurred and consequently drew upon the letter of credit and satisfied all remaining balances due under the Fourth Modification Agreement. The Deputy Receiver is evaluating the Wachovia Bank transactions and remedial action measures.

Following the commencement of receivership proceedings, the Company's licenses to conduct insurance business have been suspended or revoked in various state jurisdictions in which the Company had been previously authorized to conduct such insurance business.

22. Reinsurance

A. Unsecured Reinsurance Recoverable

The Company has unsecured authorized reinsurance recoverables of \$217,124,000 from GenRe (FID #13-2673100; NAIC #22039). The Company has unauthorized gross reinsurance recoverables of \$183,720,000 from FVR (FID #AA-3190016; NAIC #00000).

B. Reinsurance Recoverable in Dispute - None

C. Reinsurance Assumed and Ceded

1. The following table summarizes ceded and assumed unearned premiums and the related commission equity at December 31, 2002:

	Assumed		Ceded		Assumed Less Ceded	
	Unearned	Commission	Unearned	Commission	Unearned	Commission
(a) Affiliates						
(b) All Other	\$31,030,833	\$7,082,018	\$32,900,690	\$8,996,279	\$(1,869,857)	\$(1,914,261)
(c) Totals	\$31,030,833	\$7,082,018	\$32,900,690	\$8,996,279	\$(1,869,857)	\$(1,914,261)
(d) Direct Unearned Premium Reserve --	\$23,235,253					
2. Additional or Return Commission --	None					
3. Protected Cells --	N/A.					

D. Uncollectible Reinsurance - The Company had no uncollectible reinsurance written off during the year. As noted also in Note 22, Section A, the Company has unsecured reinsurance recoverables totaling \$126,713,000 with FVR as of December 31, 2002, and FVR's legal representatives have advised the Company that FVR has minimal assets available to pay unsecured reinsurance recoverables. Under statutory insurance accounting principles, FVR is an unauthorized reinsurer of the Company for financial statement purposes.

Historically, the Company has assumed virtually all of the premiums and exposure from the RRG's and subsequently retroceded this premium and exposure to GenRe. GenRe would then further retrocede the primary working layers (typically under \$1 million in individual account exposure) to FVR. According to Company records, effective January 1, 2002, GenRe no longer reinsures this primary working layer business from the RRG's for policies after December 31, 2001, and this exposure is now retroceded by the Company directly to FVR. These retrocessions to FVR were to be collateralized with a trust fund account with the Company as the sole beneficiary, since FVR is an unauthorized reinsurer.

Further, according to Company records, effective January 1, 2002, the Company entered into new agreements and modified certain existing reinsurance agreements with GenRe. The new agreements require the Company to pay to GenRe an annual aggregate deductible of \$2 million per year for a period not to exceed three years.

Also, according to Company records, effective January 1, 2002, GenRe agreed to assume all outstanding losses and loss adjustment expenses, known and unknown, under all retrocession agreements between GenRe and FVR related to the RRG produced business. In a "side letter" dated March 27, 2002, the Company agreed to limit GenRe's reinsurance liabilities at \$135 million for loss and loss adjustment expense payments made by the Company at and after January 1, 2002, related to policies in force prior to January 1, 2002. The \$135 million aggregate cap also applies to "tail cover" incidents occurring prior to January 1, 2002 which are reported on policies becoming effective from January 1, 2002 through December 31, 2005. Further, according to Company records, effective January 1, 2002, the Company entered into an Indemnification Agreement with FVR which entitles the Company to seek recoveries from FVR related to the \$2 million per year aggregate deductible due to GenRe, along with any exposure to the Company in excess of the \$135 aggregate cap. These recoverables from FVR were supposed to be collateralized by the trust fund account established for the benefit of the Company. The aforementioned reinsurance transactions involving GenRe, FVR, and/or the Company were not disclosed to, or approved by, the Bureau. The Deputy Receiver is evaluating the GenRe, FVR, and Company transactions and remedial action measures.

As a result of FVR's apparent inability to honor its reinsurance obligations to the Company, all recoverables in excess of the funds available in the trust fund account have been non-admitted via the provision for reinsurance from Schedule F.
- E. Commutation of Ceded Reinsurance - The Deputy Receiver is investigating those transactions that may have resulted in commutations, settlements, or reductions of reinsurance balances.
- F. Retroactive Reinsurance - N/A

23. Retrospectively Rated Contracts and Contracts Subject to Redetermination

NOTES TO FINANCIAL STATEMENTS

- A. The Company estimates retrospective premium adjustments by review of the individual risk and factors included in the agreements.
- B. The Company records the retrospective premium accruals through written premiums.
- C. Net premiums written in 2002 on retrospective workers' compensation policies were (\$749,201), and these premiums represent 1.8% of total workers' compensation net premiums written.
- D. The total amount of (\$919,995) in retrospective premium returns were included in the current period reported.

24. Changes in Incurred Losses and Loss Adjustment Expenses  
Reserves for incurred losses and loss adjustment expenses attributable to insured events of prior years has increased by \$103,217,000 during 2002, as shown in the chart below. This is a result of the re-evaluation of unpaid losses and loss adjustment expenses principally on the workers' compensation and medical malpractice lines of insurance. Original estimates are increased or decreased as additional information becomes known regarding individual claims.

(000's omitted)	2002 Calendar Year Losses and LAE Incurred			2002 Loss Year	
Lines of Business	Losses Incurred	LAE Incurred	Totals	Losses and LAE Incurred	Shortage (Redundancy)
Workers' Compensation	\$ 40,234	\$ 19,081	\$ 59,315	\$ 48,516	\$ 10,799
Medical Malpractice – occurrence	\$ 26,844	\$ 6,461	\$ 33,305	\$ 4,419	\$ 28,886
Medical Malpractice - claims made	\$ 75,573	\$ 65,490	\$141,063	\$ 77,761	\$ 63,302
Other Liability – occurrence	\$ 3,221	\$ 4,872	\$ 8,093	\$ 3,763	\$ 4,330
Other Liability - claims made	\$ (1,082)	\$ (1,408)	\$ (2,490)	\$ 1,610	\$ (4,100)
Assumed Property	\$ -	\$ -	\$ -	\$ -	\$ -
Assumed Liability	\$ -	\$ -	\$ -	\$ -	\$ -
Totals	\$144,790	\$94,496	\$239,286	\$136,069	\$103,217

No additional premiums or return premiums have been accrued as a result of the prior year effects.

25. Intercompany Pooling Arrangements -- N/A
26. Structured Settlements  
The Company has purchased annuities from various life insurers under which name claimants as payees. These annuities have been used to reduce unpaid losses by \$2,022,608 as of December 31, 2002.
27. High Deductibles  
As of December 31, 2002, the amount of reserve credit recorded for deductibles on unpaid losses and loss adjustment expenses was \$28,372,076. The amounts billed and recoverable, net of balances greater than 90 days past due, as of December 31, 2002 were \$1,858,479. The non-admitted portion of the amounts billed and recoverable are not included in the admitted assets of the Company.
28. Discounting of Liabilities for Unpaid Losses and Unpaid Loss Adjustment Expenses -- N/A
29. Asbestos/Environmental Reserves – N/A
30. Subscriber Savings Accounts  
At December 31, 2002, the Company has \$(229,088,324) identified to subscriber savings accounts. Of this amount, \$(229,088,324) is from company operations and is reported in Unassigned Funds (Page 3, Line 33). The balance identified to subscribers savings accounts, \$0, was contributed directly by the subscribers and is separately reported in Other Than Special Surplus Funds (Page 3, Line 30). Subscriber savings accounts balances are paid to the subscribers upon their termination from the Company. See Note 13 for additional discussion regarding restrictions placed on the return of balances to withdrawn or terminated subscribers. Pursuant to the First Directive, a moratorium has been placed on the payment of funds to subscribers.
31. Financial Guaranty Insurance Exposures – N/A